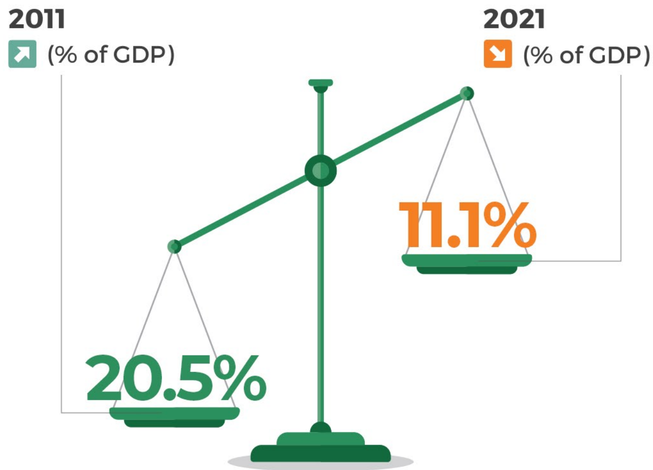
LOGIC INSIGHTS

EGYPT'S ECONOMIC RISE: BOOSTING EXPORTS

Tackling Export Bottlenecks in Egypt

LOGIC CONSULTING

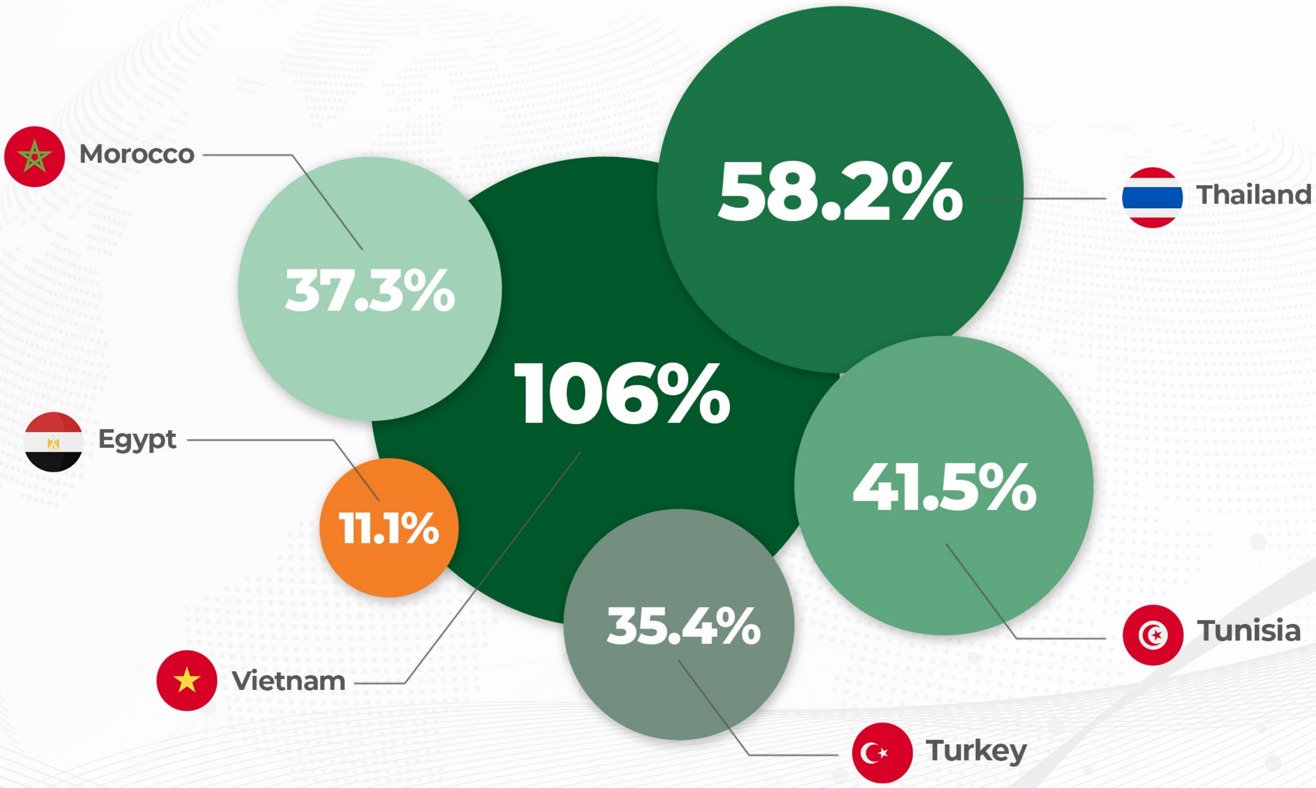
Egypt has had a negative trade balance for years, and increasing exports is a cornerstone of narrowing the current trade deficit. The initial devaluation then flotation of the exchange rate in 2016 helped in improving the trade balance as a % of GDP from -14.5% in 2015/16 to -12.8% in 2018/19. Yet, till now export competitiveness remains weak and export proceeds are well below those of peer countries & its historical average. Exports of goods and services in 2021 (11.1% of GDP) remains well below the level achieved in 2011 (20.5%).



Egypt's Exports of Goods and Services as % of GDP in 2011 vs. 2021

THE WORLD BANK

According to World Bank 2020 Enterprise Survey, less than 10% of private firms in Egypt participate in export activities – either directly, or through sales to exporting companies.



Exports of Goods and Service as % of GDP in 2021

Current Export Status in Egypt:

Low Participation in Global Value Chains (GVCs):

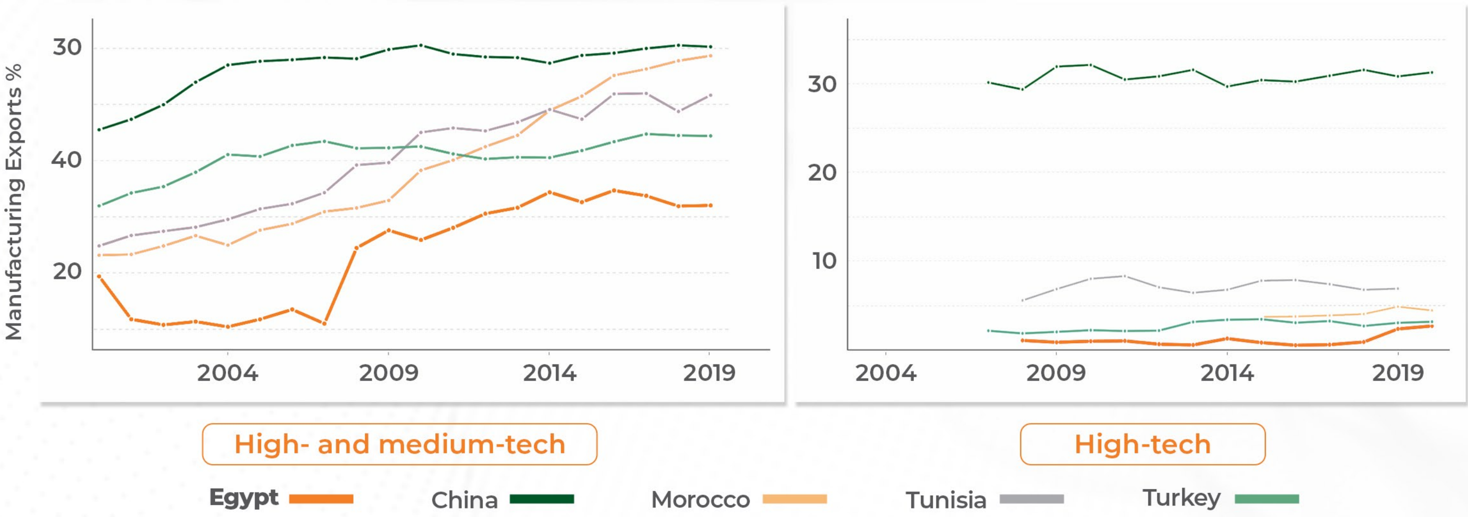
Rather than trading only finished goods, firms today move inputs and intermediate products from country to country in GVCs. About 70% of international trade today involves GVCs. Yet, Egypt's participation in GVCs is low compared to its peers, as exports are mainly centered around primary commodities and less sophisticated products.

GVCs represent a relatively attractive and straightforward option for countries seeking to industrialize. As production and operations became fragmented into networks across many locations, countries no longer need to create complete products, instead, they can "insert" themselves into a particular stage of production along the value chain that suits their existing capabilities.

Low Value-added Products:

Exports remain concentrated in products that are less sophisticated or low value-added. Between 2009 and 2018, more than half of Egypt's goods exports consisted of primary and resource based products, and about a quarter consisted of medium and high-technology exports. By comparison, in Turkey and Malaysia, medium- and high-technology exports account for 42% and 58%, respectively.

Source: World Bank



Weak Export Basket:

Products that Egypt exports most are not necessarily the ones that might be expected from the perspective of comparative advantage. According to a report by World Bank Group, Egypt seems to have a comparative advantage in carpets, fabrics, fertilizers, textiles, salt, sulfur, and stones, but exports of these products remain relatively low.

Highly Concentrated:

Export activity continues to remain heavily concentrated in a small number of governorates, with the poorest ones appearing to have no linkages to overseas markets. The biggest concentration of exports per worker is in Luxor, Cairo, Alexandria, Port Said, and Dakahlia.

Fewer Products, Fewer Markets:

Egypt exports a smaller number of products to fewer markets than comparator countries. For instance, in 2018 Egypt exported 2,063 products, compared with Turkey's 4,210. Each product that Egypt exports goes to 9 markets, on average, whereas each Turkish export goes to 30.

Egypt has a **Huge Potential** of Being an Export Hub:

In theory, Egypt has a lot of possible competitive advantages in manufacturing in terms of availability of relatively cheap labor and country's location. Labor costs in Egypt are among the lowest labor costs in the world, where it's lower than many of the developing countries such as Malaysia, Morocco, Oman, Colombia, and Mexico. The country's geo-strategic location should position it as a regional trade and logistics hub for its potentially easy access to major markets in Africa, the Arab countries, Asia, and Europe. Cargoes take less than 5 days to reach EU and 15 days to USA, turning it to a preferred sourcing location compared to its counterparts. Also, with global trends going towards a partial shift away from China, it is extremely important to showcase Egypt's potential in attracting investments, and direct them to certain sectors. With Egypt's proximity and improved logistics, it could be a hub to export to other regions.

Yet, Egypt's Performance in Exports is Far Below its Potential, So Why? What are The Constraints?

Exports Competitiveness = Strong Domestic Production + Less Trade Barriers + Support to Local Manufacturers + Export Incentives

1- Weak Domestic Production

This is due to several challenges in many areas, including:

A- Lack of Automation & Technology:

Labor in Egypt is still cheaper than the machines and equipment needed for industrial automation, so many companies tend to rely mostly on human labor. This is the case especially for SMEs that are more risk averse when it comes to shelling out large investments. Also, Egypt's exports are mainly centered around primary commodities and less sophisticated products. This is mainly due to lack of technology needed to move upstream to higher value-added complex manufacturing activities.

B- Inadequate R&D:

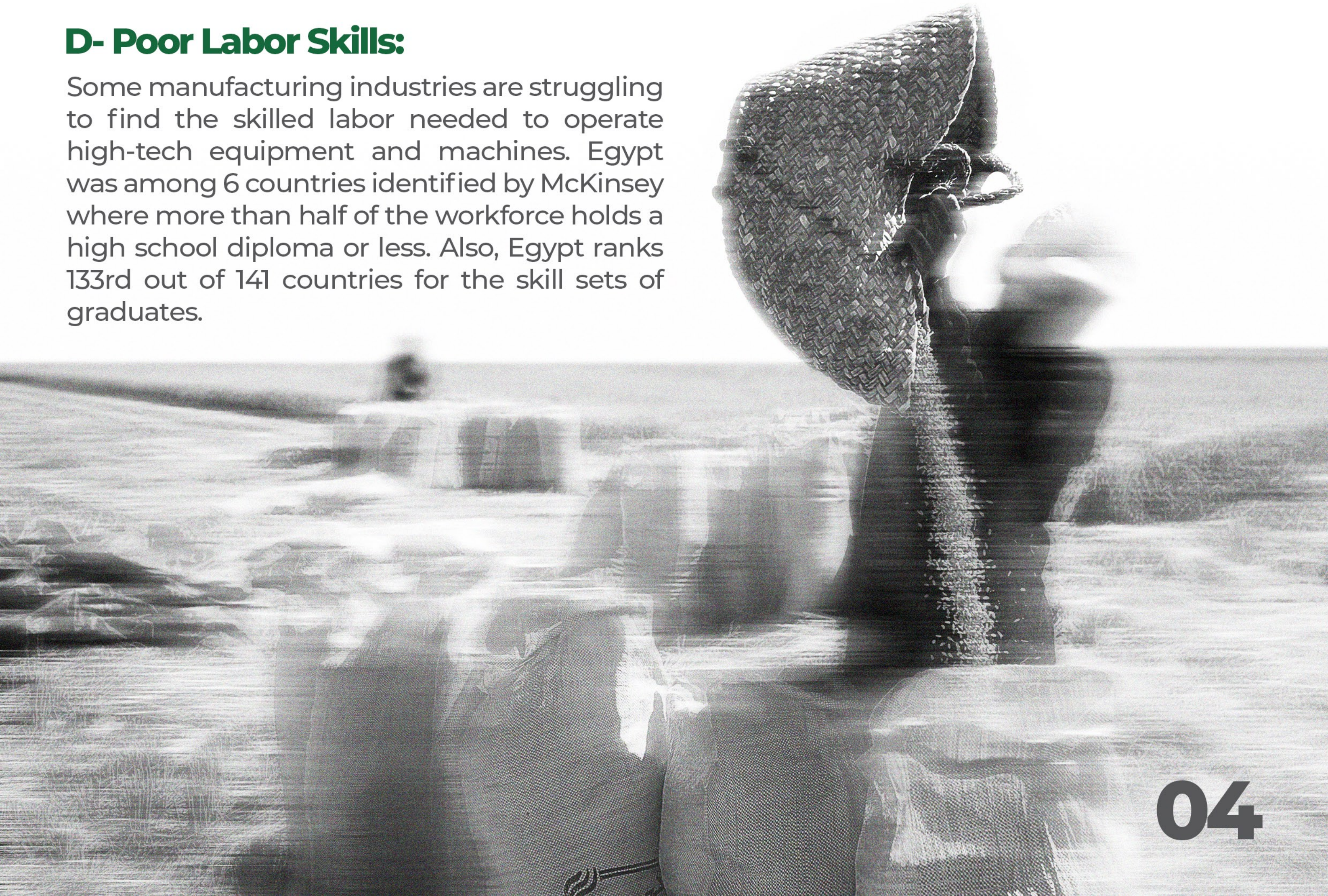
Expenditure on R&D is essential to adopt the available technology at the frontier and move up the value chain. The share of firms' spending on R&D is 4-5x higher in comparator countries in the Middle East and North Africa and in other lower-middle-income countries than it is in Egypt.

C- Increasing Cost of Production:

Egypt relies heavily on imported raw materials and inputs for both domestic production and exports, for example, the manufacturing sector imports about 48% of intermediate inputs. That's why as EGP depreciates, costs of production increases given that most of imports have no or insufficient domestic substitutes. Also, double-digit inflation and high interest rates are adding an extra burden on exporters.

D- Poor Labor Skills:

Some manufacturing industries are struggling to find the skilled labor needed to operate high-tech equipment and machines. Egypt was among 6 countries identified by McKinsey where more than half of the workforce holds a high school diploma or less. Also, Egypt ranks 133rd out of 141 countries for the skill sets of graduates.



2- Extensive Trade Barriers

Egypt has consistently supported reductions in trade barriers to boost exports and ensure smooth trade activities. Yet, Egypt is still suffering from:

A- Poor Connectivity and Logistics:

Enhancing connectivity is key to allow firms to integrate into GVCs. Egypt has high transport costs and poor logistics performance compared to other countries in the region. Logistics costs in Egypt account for around 20% of GDP compared with a global average of 10-12%. The DHL Global Connectedness Index, which measures cross-border flows of trade, investments, information and people, reveals low connectivity for Egypt, placing it below similar peers such as Morocco, the UAE and Panama. Numbers of container ship deployments to seaports in Egypt and Panama are similar despite the fact that much larger ships can pass through the Suez Canal. Yet Panama ranks 29 places higher than Egypt on the Logistics Performance Index.

B- Unfavorable Trade Policies:

Globally, Egypt's performance in Trading Across Border Indicator in the Doing Business is one of the lowest, where it ranks 171 out of the 190 economies. Egypt is considered the second-most-protected economy in the world after Sudan. It is characterized by a high level of protection through tariff and non-tariff barriers, putting it in a weak position especially when compared to other lower middle-income countries. It also hinders expansion to global markets especially for SMEs, who are resource-constrained. Non-tariff barriers, which include lengthy procedures, heavy documentation requirements and costly clearance process for imported and exported goods are imposing high fixed costs on firms, affecting their ability to export. Also, according to a report published by World Bank Group, the trade environment is highly complex in Egypt, with at least 33 government entities involved in regulating trade, further complicating the process for importers and exporters.

C- Lack of transparency in Investment Environment:

Attracting more investments and boosting exports is currently one of Egypt's national priorities. Yet, Egypt's vulnerability to changes in investor sentiment still persists, resulting in a continuous suboptimal performance in attracting FDI's. This is due to many factors including: a) lack of transparency of public financial management and monetary policy, b) Lack of streamlined import and export procedures, c) Lack of transparency and predictability of customs and tax enforcement.

3- Inadequate Support to Local Manufacturers

A- Weak Export Promotion:

Local manufactures have weak access to international markets through effective marketing channels. SMEs, in particular, face difficulties in penetrating the export market due to weak marketing.

B- Lack of Intelligence on Export Markets:

Firms lack information about export markets, end market preferences and regulations that need to be met. For example, African markets require immediate delivery, unlike others where deliveries' speed is not as important. There should be institutions to conduct the technical and marketing research needed to upgrade the quality of Egyptian products to make them more appealing in the international market. Also, firms usually have limited / no business contacts in targeted export markets. Firms need to have access to list of buyers, agents, distributors and other potential industry partners overseas.

C- Inadequate Training:

To unlock innovation and diversification, Egypt needs to address capabilities challenge by offering high-quality training in advanced, technologically-related areas, such as AI, digital technologies and other areas increasingly demanded by global markets. It is also important to provide technical-support programs for manufacturers in order to enable them to obtain international quality certificates that will significantly improve their products' competitiveness.

D- Inadequate Industrial Infrastructure:

Development of the manufacturing sector over the long term will require adequate space for new manufacturing capacity to accommodate increased exports. The main problem lies in attaching utilities and infrastructure to industrial land, giving the tight public budget. Also, according to Enterprise, there is a red tape problem, as it appears that the IDA has been allocating land faster than it takes to get the utilities installed due to involvement of multiple agencies in the land allocation and utility development process.

4- Inadequate Export Incentives

Government should work on alleviating the burden on manufacturers and exporters and provide them with price flexibility, so they had a competitive edge in overseas markets. Yet, exporters still suffer from:

A- Poor Access to Finance:

According to a report published by the IMF in July 2021, 30% of companies who directly export report that access to finance is a major constraint. This is supported by the evidence that only about 2% of investment by export firms is financed by banks. Also, according to Magdy Tolba, chairman of Cairo Cotton Center and former head of the Export Council of Spinning and Textiles, Banks need to be open to providing capital to different sectors. Banks tend to consider some textile industries high-risk and, consequently, refuse to provide them with the necessary funding to upgrade their production lines.

B- Rigid Export Initiatives:

According to English Ahram, while the current export-subsidy initiative allows for the settlement of any tax or customs dues against the arrears, it should be expanded to include settlements against electricity, water, and gas bills. Also, according to The Chemical and Fertilizers Export council's vision, exporters should be provided with 100% of the value of the support allocated to them in the same year, a step that would provide them with liquidity.

C- Lack of Technology-related Incentives:

Firms need to have incentives to upgrade their technological capabilities and production processes to start focusing on higher value-added and technology-intensive products. Also, customs duty exemptions on imported equipment used in R&D activities should be considered.

> **While Currency Depreciation was Expected to Boost Exports in the Short-term, Sustained Export Growth Requires More Than a Price Effect.**

So, How Can Egypt ensure a Sustainable Long-run Export Growth?

1- Growing Industrial Sector

Industrial Land with Utilities: The government should work on facilitating the acquisition of land with necessary utilities at feasible prices, especially for small investors who are facing a shortage of appropriate industrial land.

Engagement with private sector, including SMEs: This needs to be done by considering both big local and multinational companies and SMEs. The government needs to make sure that SMEs receive the whole package of support: technical, financial, and marketing, etc. Also, more public-private partnerships should be created in expanding areas of developing infrastructure and key projects to help minimizing trade barriers and boosting manufacturing sector.

Land Clusters Development & Promotion: Existing clusters do not necessarily comprise companies with related activities. Land-plots in Egypt should be set up to accentuate the integration of vertically and horizontally related industrial activities for boosting the efficiency of industrial units and facilitating the delivery of industrial services. Following this, relevant stakeholders should work on strengthening the ecosystem for selected growth-oriented sectors and industrial zones in Egypt and maximizing their value potential.

Medium and High-Technology Exports: Medium-technology industries are the heartland of industrial activity in mature economies, comprising the bulk of skill and scale-intensive technologies in capital goods and intermediates. Engaging in international trade dynamism necessitates increasing the visibility of Egypt's medium- and high-technology manufactured exports. Being part of this type of chains requires high level of technological and skills attainment, and thus huge investments are required.

2- Improving Investment Climate

Better Communication: This entails more transparency on both Egypt's Monetary Policy and national export strategy & execution plan.

Attractive Programs: For example, developing a program to attract the top 1,000 companies to open a manufacturing plant or their regional headquarters in Egypt or establishing a VIP service for large investors (e.g fast track access to financing, obtaining solutions they need at lower prices, loans with longer grace period and lower interest rates, etc.)

Competitive Incentives: Developing customized and tailored incentive schemes for the selected industries in accordance with what other developing nations are offering.

3- Boosting Export Promotion

Export Promotion Agency: Egypt has made some initiatives to promote the successful entry of the country's key industries into the export sector. Yet still the country needs to strengthen 3 main vehicles for export promotion: a) raising awareness for potential exporters, b) providing specialized training packages for companies interested or already exporting to target export markets, c) providing integrated market intelligence services for exporters including market data on target export markets, regulations that need to be met, certifications and export standards across different markets.

National Champions Program: Many countries have launched their national champions program including Turkey, Singapore and France, to support companies with strong potential and ambition. According to Aly Waly, Ex-Partner at LOGIC Consulting, Egypt should begin implementing its program to grow national champions (e.g. companies selling for 20 million EGP/year should get into a specific program to help them grow to 200 million EGP/year in 7 year period).

4- Enhancing Regulatory Environment

- **Less Governmental Entities to regulate trade and reduce bureaucracies.**
- **Involvement of macro-economists in the decision making on the optimal level of Trade Protectionism.**
- **More Protection for Investors.**
- **Having Planning & Execution Entity for Export Strategy reporting to the top decision-maker.**
- **More Trade and Export Credit Facilitation.**

Sources:

-https://enterprise.press/industries/encourage-local-industry-according-manufacturers/
-https://openknowledge.worldbank.org/bitstream/handle/10986/35629/International-Trade-and-Labor-Markets-Evidence-from-the-Arab-Republic-of-Egypt.pdf?sequence=1&isAllowed=y
-https://www.ifc.org/wps/wcm/connect/af513599-08b4-45a4-b346-1a44de58cda6/CPSD-Egypt.pdf?MOD=AJPERES&CVID=npT1-BJ
-https://english.ahram.org.eg/NewsContent/50/1202/411408/AlAhram-Weekly/Economy/Egypt-Expanding-export-capacities-.aspx
-https://businessforwardauc.com/2022/06/20/debts-and-egp-devaluation-how-can-egypt-make-it-through-the-bottleneck/
-https://www.oecd-ilibrary.org/sites/fbde3af9-en/index.html?itemId=/content/component/fbde3af9-en
-https://www.gtreview.com/supplements/gtr-mena-2022/going-local-egypts-plans-to-slash-its-import-dependency/
-https://enterprise.press/wp-content/uploads/2022/03/OECD-report-on-Egypts-industrial-capabilities.pdf
-https://enterprise.press/afternoons/pm-manufacturers-lagging-behind-comes-industrial-automation/
-https://www.morocconow.com/wp-content/uploads/2021/10/Policy_Paper_Deloitte.pdf